

COPPER SUGGESTING RALLY

by Simon Bridgland

Recently, most eyes have been watching out for job data numbers, employment figures, manufacturing data, retail figures, inflation, currency and interest rate movements in order to gauge a reading on where the economy is at – however, the copper price or ‘Professor Copper’ is a master of economics and has an impressive track-record in predicting where Australian stock markets are heading.

Let's explore

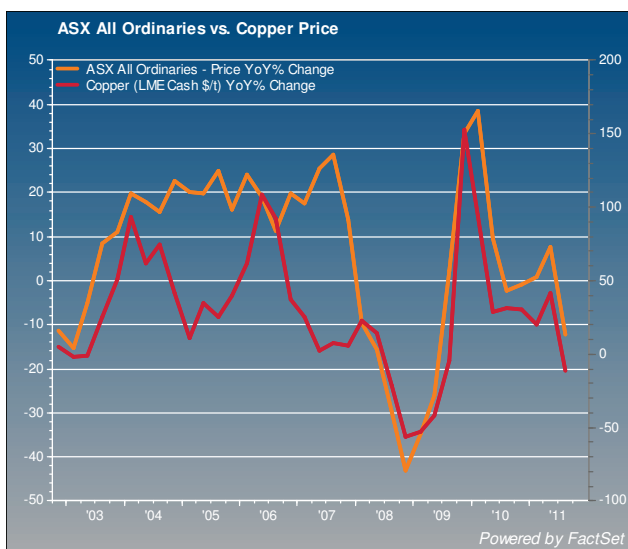
In 2003, the economy began to recover from the 2001 downturn, and copper was one of the first commodities to gather momentum as we entered a bull-market for the next 6 years.

When the credit crisis emerged in 2008, copper began to fall from July onwards. The decrease in copper was well ahead of the stock market fall, which peaked in September and October 2008.



Copper found its ‘bottom’ in December 2008 and in the last few days it began a strong rally upwards. However, the ASX 200 and other global markets did not begin to recover until 6 March 2009 - which turned out to be the ASX's bottom. Over the next 12 months, the ASX 200 rallied approximately 50%, while copper surged nearly 100%.

Although the copper price cannot solely predict where equities are heading, over recent times, a rise in the copper price has been an excellent proxy for the Australian stock market (refer to chart below).



Equities versus commodity prices

The prices of most major commodities have fallen away this year as we have witnessed the economy deteriorate further. With factors such as the European debt crisis impacting financial markets, and fears over the slowdown of the U.S. and Chinese economies in particular, we have seen investors take the ‘risk-off’ path as negative sentiment continues to linger and markets have experienced extreme volatility. The most important point to take away from this fall in commodity prices is that mining stocks have significantly underperformed commodity prices year-to-date.

If we take a closer look at copper, the underlying fundamentals for the copper price remain very robust. China is the world's biggest user of the metal, and the Chinese have been de-stocking their copper inventories for the last year in an attempt to cool down the raging copper market. Although the data out of China is limited, it is believed by many that this de-stocking process has come to an end and that the copper price has now bottomed.

The Chinese have a huge demand for copper as it is absolutely critical for the manufacturing of infrastructure, housing and practically anything electronic. The numerous natural disasters globally have caused copper demand to rise, and it could be observed that it's only a matter of time before the Chinese start to restock their copper supplies (if they haven't already begun).

How should we profit from this?

For those that are copper followers, you may recall the corporate activity that took place in Australia in April this year. At the time, Equinox Minerals was the largest pure-copper stock on the ASX and it received a takeover offer from Canada's Barrick Gold (the world's largest Gold miner) at a substantial premium to its share price. The offer was accepted, which leaves PanAust Limited (PNA as one of the largest pure-copper producers on the ASX).

PNA operates copper and gold mines in South East Asia, and its Phu Kham mine in Laos produces nearly 65,000 tonnes of copper per annum, and relative to the rest of the industry, the cost of running the mine is below average.

In May 2011, PNA informed the stock market that its total ore reserves at Phu Kham had increased by 37%, with these ore reserves containing copper, gold and silver (increasing by 20%, 38% and 55% respectively). In the update, the mine life at Phu Kham was also extended to more than 14 years.

PNA is also well diversified with a gold development in Ban Houayxai (25km from Phu Kham) and another copper-gold project in Chile. Debt was paid down in 2009 through an equity raising, and it is expected that the cash flows that are generated from Phu Kham will fund the development projects going forward. Sovereign risk in Laos and Chile is recognised as being average which provides some project certainty.

So, with this in mind, maybe it's time to listen to the good professor and consider adding a copper stock to diversify your portfolio.